

Poverty-Problem Country Typologies



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by

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INTRODUCTION

A country typology is a classification system based on important economic features that vary across countries. Economic typologies involve a country's structural features, temporal conditions, and policies. Structural features are lasting characteristics, such as the degree of natural resource endowment. In contrast, temporal conditions are important characteristics that are subject to short-term change, such as being in certain stages of a business cycle (e.g., a recession) or facing high export prices. Finally, policies refer to government actions that attempt to alter the way an economy functions. Familiar examples include trade and macroeconomic policies.

Economists design typologies for a variety of purposes, most frequently as an aid in understanding how economies work or, as in this project, in facilitating policy selection and design. Although these two purposes tend to overlap, they are not identical.

When Are Typologies Most Useful?

Typologies are particularly useful when the optimal policy package (including how its various components will be implemented) varies *significantly* across a range of country types. Accordingly, economists tend to build typologies around important structural features and policies. If we consider trade policy to be critical to achieving economic growth or reducing poverty, for example, it is logical to build a typology around the degree of export orientation or around products in which the countries under consideration have comparative advantages.

Typologies also are useful when many of the country characteristics on which the optimal policy package depends are interrelated so that countries cluster rather than spread evenly across the n-dimensional matrix. Put another way, a useful typology employs two to four key defining features to categorize large numbers of countries. If the distribution of countries by degree of each particular feature were smooth (no bunching) and uncorrelated across features, then it would not be possible to identify a small number of categories made up of reasonably similar countries. In this case, the optimal policy package would gradually vary across the whole country-feature space.

Fortunately, the features on which we select optimal policies tend to be fairly highly correlated. This diminishes the number of distinctions needed. For example, higher-income countries tend to be urban, have a highly educated work force, and have high female participation in the economy. Policy makers working in this environment therefore can design policy based on this combination of features. In contrast, lower-income countries tend to be rural and agriculturally based and have lower levels of formal education. In these countries, policy makers should focus, for example, on improving agricultural technology in ways that are useful to farmers and on upgrading rural infrastructure.

A country typology for pro-poor policies is especially valuable when the optimal policy package for one country type is counterproductive and hence undesirable for countries on the

opposite end of the spectrum. In this situation, identifying where a country fits matters most because the right policy package for a country falling in one category could be precisely the wrong package for a country falling in another category.¹

As discussed earlier, there are many ways to build typologies. Which type we build depends on critical policy areas and policy objectives. That is, how we intend to use the typology drives the type of typology that we build. Because poverty reduction is a joint result of economic growth and changes in income distribution, both growth- and distribution-related typologies warrant consideration.

Caveat Emptor: The Need for Care in the Use of Typologies

In using a typology, policy makers must keep in mind that most countries do not fit neatly into a typological box. For example, although Botswana is rich in natural resources, Mali is resource poor, but most countries fall somewhere between these extremes.

Policy makers also must keep in mind that the factors used to characterize countries are dynamic. Countries can, for example, discover and exhaust natural resources, and they can improve the skills of their labor base through training.

TYPOLOGIES BASED ON STRUCTURAL FEATURES

Factor Availability

Effective pro-poor policy differs according to the absolute and relative availabilities of labor (quantity), skills (quality),² and natural resources. Most pro-poor policies involve mainly raising the labor income of the poor. Because factor proportions differ between countries, the appropriate policy responses and actions to achieve this objective also differ.

Supply of Labor. Policy makers in countries with an abundant labor pool should design pro-poor policies to stimulate the use of excess labor. The anticipated result is an increase in wages and/or earnings of poor people. Potentially useful policies and strategies include:

- Increasing exports of labor-intensive goods;
- Encouraging the use of labor-intensive technologies; and
- Promoting labor-based infrastructure construction programs.

Key pro-poor policies, working through increases in the demand for unskilled labor, include:

¹ The most famous example might be the appropriateness of a balanced budget under full capacity utilization conditions and its inefficiency under conditions of widespread resource underutilization.

² Although skill levels change over time, this is a gradual and hence a long-term process. We therefore define a high (or low) skill level to be a structural feature of a country.

- Exchange rates that make it profitable to export and compete with imported goods;
- Unskilled labor costs that are not artificially inflated by minimum wages or constraints on worker dismissal; and
- Interest rates that are not artificially low.

Skilled Labor. A country's labor force can range from skilled to unskilled, and we can measure its position on this continuum using, for example, the educational attainment of the work force. Countries with abundant skilled labor tend to have a low incidence of poverty. They also enjoy an international comparative advantage in skill-intensive products. Pro-poor policies in countries with a substantial skilled labor force should aim to increase the profitability of hiring unskilled labor and to upgrade the productivity of self-employed labor. Governments in these countries should formulate policies and fund programs to enhance productivity in the private sector.

The spread of skilled labor across a country's population also is important. Inequality is typically a problem in countries where skills are concentrated in certain areas or among certain groups. The policy maker's challenge is to maintain an adequate demand for unskilled labor until education and training reach the rest of the population.

Natural Resource Endowment. In countries with abundant natural resources, industries that export natural resources typically do not generate many jobs. In these countries, a small (in terms of employment) high-productivity sector and a large low-productivity sector typically polarize the economy; society suffers the associated income inequality. These countries must design poverty reduction policies that invest the profits generated by resource exploitation in activities that train and employ the less skilled. At the same time, these policies must prepare society and the economy for the day when resources are less abundant.

Accordingly, pro-poor policy in natural resource-abundant economies involves managing the exchange rate to avoid the "Dutch disease" problem. In these countries, policy makers must manage the exchange rate and fiscal policy to soften the impact of fluctuating terms of trade and must steer away from the pro-cyclical fiscal policy that typically leads to boom-bust public spending cycles. Pro-poor policies in resource-abundant countries also must seek to increase the profitability of hiring unskilled labor and/or upgrade the productivity of self-employed labor. At the same time, governments must allocate significant public funds to support the growth and increased productivity of the private sector, especially small and medium-sized enterprises. Such strategic use of public resources is critical if living standards and human capital are to be improved.

Geography and Ease of Interaction with the World Economy

The geographic characteristics of a country often define the level of its interaction with the rest of the world economy. We should view these characteristics in conjunction with those related to factor availability since both have implications for a country's international comparative advantage. The importance of making full use of the country's comparative advantage based on its resource endowment varies with how easily it interacts with world markets for goods and factors.

Economic Proximity to External Markets. Countries close to world markets, in terms of transport and communications costs, have great potential to benefit from international trade. Countries further removed from those markets have decidedly less potential. For these latter countries, the optimal pro-poor policy package involves greater attention to creating jobs in non-tradable sectors.

Geographic Size. Domestic markets, rather than exports, tend to fuel growth in geographically large countries. In these countries, as a result, exports tend to play a small role in poverty reduction policy. Wage restraints, which can be important in small export-oriented countries, are less attractive in large economies since higher wages help expand the domestic market, which is clearly important to domestic producers.

Labor Mobility. Countries where the labor force can easily relocate can reap considerable benefits from temporary emigration and the resulting inflow of foreign exchange. Policy can organize and facilitate this process.

Level of Economic Development

The level of development is closely correlated with the degree of urbanization and the role of agriculture,³ each of which are closely related to the incidence of poverty and to who the poor are and where they are found.⁴ The lower the average income of the country the less urbanized and the more agricultural it tends to be. Poorer countries usually export primary goods and commodities, and perhaps some simple manufactured goods.

In terms of poverty, the major difference between low- and high-income countries is that the latter tend to have fewer poor (relative to population) and that poverty tends more frequently to be associated with personal characteristics (physical inability to work, single parenthood, etc.). Governments in low-income countries have more limited resources to devote to poverty reduction and therefore cannot implement high-cost programs. Policy and program design follows accordingly.

³ Much pioneering work on the "normal" or typical relationships between the level of development and other economic variables is attributable to Hollis Chenery (1975, 1979).

⁴ Average educational attainment also is correlated with the variables involved in this typology, but both that average and the structure of such attainment vary considerable even for countries at the same income level. Accordingly, we use education as one of the bases for a related "human development" typology (see below).

In poorer countries, pro-poor policy should:

- Target large groups of people;
- Focus on raising productivity and employment opportunities in agriculture and in rural, non-agricultural activities;
- Ensure complete coverage of primary education and primary healthcare, especially in rural areas; and
- Exercise great care in the use of interventions to push wages above the equilibrium level because these interventions are more likely to help the non-poor than the poor.

In contrast, pro-poor policy in wealthier developing countries should:

- Aim to create employment outside agriculture, especially in small and medium-sized enterprises;
- Dedicate resources to pro-poor urban development, including sites and services programs, and extension of electricity, water, and sanitary services to poorer neighborhoods;
- Focus on increasing the quality of education received by the poor and improving their access to secondary education and vocational training;
- Address the characteristic causes of poverty through targeted safety-net programs.⁵

Human Capital

Human capital is a key factor in economic progress; lack of such capital or its low utilization contributes significantly to poverty. The main pro-poor policy implication here is that countries with an abundance of human capital can engage in human capital-intensive (and therefore remunerative) activities, both as a base for exports and (using some of the resulting earnings) as a way to fund poverty-reduction programs.

Countries lacking in human capital, in contrast, do not have this option and must rely either on their natural resource base or on their unskilled labor force. They also must

⁵ Countries that are outliers from the normal relationships among the three variables incorporated in this typology are of interest both because they may provide good windows for the study of the implications of, say, an unusually high level of human capital and because their policy challenges will be somewhat different from those of the “normal” country. Some of these anomalies will be related to distinctions made above. Thus, a country that is highly urbanized despite low-income levels is likely to be one whose comparative advantage does not lie in agriculture (Peru). Others are the result of special policy decisions, such as the atypically high level of education in Sri Lanka; that anomaly provides interesting evidence on the payoff to education.

improve the coverage or quality of primary education and healthcare. Benefit-cost calculations usually show high rates of return to such investments so they will promote growth as well as reduce poverty. A needed complement to that policy is to make special efforts to find unskilled labor-intensive activities in which the country may have a comparative advantage.

In some cases, the human capital deficit is less general and more concentrated in certain groups of the population. One example involves low female education rates. An appropriate poverty-reducing response is to improve the quality of and the access by girls to primary and secondary education. Education of girls usually leads to higher female labor force participation rates, lower rates of population growth, more and better education of the next generation, and more effective allocation of the low-income household's resources.

In countries where indigenous peoples have high rates of impoverishment, policies must aim to improve the coverage and quality of the schools in regions where indigenous peoples reside and consider the merits of teaching in indigenous languages.

Income and Wealth Inequality

Pro-poor policy making must take into account the level of inequality in a country. Income inequality has a variety of direct contributing factors, including unequal ownership of such key assets as land and a high variance in the level of education of the population. Often ethnic, tribal, or religious differences are associated with some or all of the other factors contributing to inequality. In these cases, inequality has a strong cultural feature, and poverty may be concentrated in a particular ethnic category.

Inequality is usually also closely connected to and manifested in differentiated access to technology, typically between well-connected (usually large) enterprises and not well-connected (usually small) enterprises.

Effective pro-poor policy in a country with a high level of inequality will include programs to transfer productive resources to the poor, as with titling public lands to them (since a lack of resources is a proximate cause of poverty) and to provide them with appropriate technology. In this type of economy, much attention from both the private and public sectors is already being given to advancing the highly productive (per unit of labor) modern sector but often little to the needs of the smaller-scale producers and subsistence farmers.

Other ways to help the poor, directly or indirectly, include steps to facilitate mutually beneficial linkages between the large-scale modern sector and smaller-scale producers that employ more lower-income workers and to address the capital market imperfections that tend to put smaller enterprises at a disadvantage relative to larger ones. In the many cases where poverty is strongly correlated with ethnicity, additional steps are needed, including addressing ethnic inequalities by raising the coverage and quality of education and health services to indigenous or other disfavored groups and by reducing other forms of discrimination against these groups.

Governance

Administrative capacity, degree of decentralization, and political stability are important aspects of a country's institutional structure that can affect the success of its overall development and also the nature, extent, and possible responses to poverty. These factors may or may not be closely correlated with one another; for present purposes, they are treated as independent features of institutional structure.

Administrative Capacity. Weak administrative capacity means that many policies that might otherwise be carried out successfully cannot be. In this situation, the policy maker must figure out which interventions are most likely to be at least somewhat successful. Under these conditions, pro-poor policy should normally involve only limited intervention. For example, inducing a decline in the price for food staples by selling public stocks or importing hold much more promise than attempts to control prices through administrative and legal means. Finally, pro-poor policy needs to be applicable without modification to many groups rather than tailored to fit the needs of smaller groups.

Level of Centralization. Decentralization is expected to improve policy design and implementation in many areas because of closer contact with presumed beneficiaries, greater transparency, and so on. Decentralized decision making is most likely to aid the effectiveness of pro-poor policies when the local administrative unit is small enough to be fairly homogenous and mostly made up of poor people who know best what is most important to their welfare. Under a more decentralized administrative system, pro-poor policy can focus on specifically local ways of raising incomes or improving welfare, such as investment in local infrastructure, and can rely more on the participation of local people to carry out the policies and programs in question.

Political Stability. Political instability lessens the continuity of policies and curtails long-range planning. Under such circumstances, the best pro-poor policies and programs are those that operate independently of central government administration and finances.

Level of Corruption. If corruption is a serious problem, policies must be formulated to lower incentives for such behavior and raise the obstacles to it. More specifically, policies in corrupt environments should be transparent, seek broad participation in decision making and implementation, and lead to small- rather than large-scale interventions.

TYPES BASED ON TEMPORAL CONDITIONS

Wars and Natural Disasters

Wars and natural disasters⁶ are the direct cause of much poverty in developing countries, especially in sub-Saharan Africa. They disrupt production and stop economic growth. They often worsen the distribution of income and wealth and limit the policy tools that can be used to confront poverty. In these settings, poverty reduction is a much more difficult and complex task than it is in more stable circumstances. Important pro-poor policies include:

- The development of systems to distribute and allocate food aid so that a reasonable amount of it reaches the poor (particularly so that it does not facilitate war-making by one side or another); and
- Restarting food production quickly, through the distribution of seeds and food to feed the poor through the next harvest.

A valuable complement to these food-related policies is the establishment of low-wage public employment programs to help people survive and use otherwise unemployed labor (e.g., to build or rebuild infrastructure).

International Debt

Policies in countries that have massive international debt should reflect this fact in several ways. First, the need for greater fiscal stringency implies a preference for lower cost policies and programs of all kinds, including those falling in the pro-poor category. Second, the need to raise exports and curtail imports makes it especially important that the exchange rate not be overvalued and that policies support pro-poor export and import competing activities.

Recent Economic Trends

The macroeconomic context has an impact on which pro-poor options are likely to work; it is easier to reduce poverty with most pro-poor options in a buoyant economy. Thus, microcredit systems channeling funds to activities whose products are not necessities are not a good bet to contribute to poverty-reducing employment when the economy is stagnant. Instead, a better direction is to raise the capacity of poor families to produce their own food and other necessities.

⁶ At a more detailed level of discussion, it would be appropriate and necessary to distinguish wars (man-made disasters) from natural disasters, since pro-poor policy would differ in a number of important ways.

Recent Prices and Wage Trends

Countries that are suffering or have recently suffered severe bouts of inflation must give high priority to achieving reasonable price stability and to persuading economic agents that high inflation will not recur. This creates a difficult challenge for pro-poor policy since policies affecting wage levels are constrained by the need to keep inflation low and public expenditures within bounds.

At the same time, however, either conservative wage or macroeconomic policy carried too far will unnecessarily hurt the poor. Thus, it is important to assess current needs with precision so that unnecessarily low wages will not lead to avoidable poverty and that unnecessarily tight macroeconomic policy will not lead to avoidable recession, with the resulting increase in poverty.

TYPOLOGIES BASED ON POLICIES

Openness to the World Economy

Optimal anti-poverty policies and programs are different for countries that interact heavily with the world economy and for those that do not. For example, in open economies, it is important that policy link the poor directly and indirectly to export activities. Where a country's exports are all labor intensive, this happens naturally. In many cases, however, the export activity creates many jobs only if small and medium-sized firms are incorporated into it, so it is important to facilitate their involvement.

Policy makers should note that it is sometimes necessary to protect the poor from being excluded from the benefits of export activities through intense competition, as when the poor are pushed off land that proves valuable for an export crop. It is also important to create flexible mechanisms to counteract the negative impact on the poor of the greater volatility that characterizes relatively open economies, especially if many of their exports are primary goods or if their capital markets are open. The severe economic recessions that result throw many people into poverty. Employment-creating public works projects that governments can implement quickly are an element of such a response. Stabilization funds are an attractive option in countries with volatile export markets.

Market and Transitional Economies

The transition from central planning to a market economy creates special challenges for pro-poor policy. This results in part from the fact that public enterprise undergoes downsizing in such countries and there is not yet a reasonably productive informal or small-scale private sector to reabsorb displaced workers, making it hard for them to find income-earning opportunities. Another factor is that some of the anti-poverty response mechanisms of market economies—such as fairly well-functioning markets for the output of microenterprises and

small firms, a capital market, and an informal labor market—are not yet performing well, leaving poor people with few opportunities. Nor has public sector or nongovernmental organization support for such employment-creating activities evolved very far.

To reduce poverty in these economies, policy makers must pay special attention to achieving a rapid overall rate of growth. This is more important in transitional economies because traditional safety nets have been partly or wholly dismantled. Many of the pro-poor policies implemented in market economies, however, are harder to implement given the lack of an institutional base for them. The development of a strong institutional base, especially to push rapidly ahead with the support system for small private enterprises, is thus another priority. Standard pro-poor policies such as public works projects are another important element of the policy package in these cases.

TYPOLOGIES AND THE DESIGN OF PRO-POOR POLICIES AND PROGRAMS

Country typologies are a useful aid in the design of pro-poor growth strategies because they highlight distinctions across countries that imply differences in what are the most effective components of such strategies. Economists base typologies on differences in key structural features, temporal conditions, and policies. Effective use of a set of typologies to guide policy in a given country involves, first and foremost, identifying where the country fits in the typology. It also calls for recognition that the distinctions on which most typologies are built are matters of degree rather than of kind. Finally, several typologies may provide different but consistent types of policy guidance for a given country.

A key objective of the forthcoming Guidance Manual on Pro-Poor Economic Growth Policies is to provide a matrix that highlights how the main elements of the package of pro-poor policies and programs differ depending upon which categories in the typology a country falls into. It also will provide a list of key indicators that may be used to identify where the country fits.

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The goal of the USAID-funded Pro-Poor Economic Growth Research Studies and Guidance Manual Activity is to identify and disseminate policies, reforms, and activities that USAID decision makers can incorporate into their programs and that they can recommend to countries wishing to pursue strongly pro-poor, poverty-reducing, economic growth objectives.

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